

Upbeat Bank of Canada subtly hints at near-term rate hikes

The Bank of Canada left rates unchanged today at 1.25% as Nafta uncertainty continues to weigh heavily. But more optimistic language suggests tightening may not be far away



Source: Bank of Canada

The Bank of Canada kept interest rates on hold, however the tone of its statement was notably less cautious than before. The Bank said that "higher interest rates will be warranted to keep inflation near target". It seems the main reason for keeping rates unchanged at this meeting is the ongoing uncertainty surrounding 'trade policy', implicitly referring to the North American Free Trade Agreement (Nafta) and US tariff developments.

1.25%

 Policy Rate

As expected

Time is running short for Nafta. The exemption on US steel and aluminium tariffs given to Canada

and Mexico is due to end on Friday. Meanwhile, the clock is ticking on the ability of a Republican congress to sign any deal ahead of the November US mid-terms and ahead of the possible expiry of the Trade Promotion Authority (legislation that allows President Donald Trump to negotiate international trade agreements, which Congress can then reject or approve but not amend). That said, another key deadline, the Mexican election on 1 July 2018, now appears to be less of a time constraint following the Mexican Economy Minister Ildefonso Guajardo's suggestion that he can negotiate until 1 December 2018, even if the opposition wins the vote.

But given the deadlock in negotiations, with a number of key sticking points and a “no Nafta is better than a bad deal” rhetoric from Canadian Prime Minister Justin Trudeau, the chance of an agreement being made over the next few days or possibly weeks appears to have diminished.

Despite this, we still think that a deal can be reached, particularly given the time pressures on all three fronts to achieve a quick “win-win-win” outcome. Assuming this is the case and activity data continues to perform better, we still expect the Bank of Canada to hike twice in the second half of the year, potentially starting in July.

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